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IN THE

Supreme Court of the United States

October Term, 1953

No. 168

FORTEE PROPERTIES, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on April 5, 1954 reversing the decision of the Tax Court of the United States in favor of the petitioner.

Opinions Below.

The findings of fact and opinion of the Tax Court of the United States (R. 9-17) are reported at 19 T. C. 99. The opinion of the United States Court of Appeals for the Second Circuit (R. 18-20) is reported in 211 F. 2d 915.

Jurisdiction.

The judgment of the United States Court of Appeals for the Second Circuit was entered on April 5, 1954 (R. 20, 21). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

Question Presented.

Should a taxpayer who realized a capital gain upon the involuntary conversion by eminent domain of his property into money, part of which was paid by a separate award directly to the holder of unassumed mortgages in satisfaction thereof, lose the deferment of the recognition of such capital gain under Section 112(f) of the Internal Revenue Code to the extent of the moneys so paid directly to such mortgagee and over which moneys the taxpayer never had any dominion or control and which moneys were not paid to the taxpayer "directly, indirectly or constructively" (R. 16)?

Statutes Involved.

The pertinent statutory provision, Section 112(f) of the Internal Revenue Code and Section 29.112(f)-1 of Treasury Regulations 111, promulgated under the Internal Revenue Code are printed in Appendix A, *infra*, page 14.

Statement.

The facts as stipulated (R. 3-8) and as found by the Tax Court (R. 9-12) are as follows:

The taxpayer, a New York corporation, purchased two adjoining pieces of real property in New York City on June 5, 1942, which were then subject to two past due mortgages, one on each parcel in the amount of $18,000, which had been placed on the properties in 1910 by a prior owner. Central Savings Bank, mortgagee, held the two mortgages. The taxpayer paid $4,000 in cash for the properties and an additional amount of $397.01 in acquiring them. It took the properties subject to the mortgages but never assumed payment of, or legal liability for, the

principal debt or interest covered by the mortgages (R. 9-10).

The Port of New York Authority took the two properties for public use on August 14, 1947, under its power of eminent domain by condemnation proceedings. The amount then due on the two mortgages was $28,970. The final decree of the Court in the condemnation proceedings approved, in connection with the two properties here in question, the award of $74,000 for the unemcumbered fees as set forth as follows in "the tabular abstract of award" annexed to the decree (R. 10-11):

Damage Parcel Nos.	*Owners*	*Estimated Loss or Damage*	*Final Awards*
• • •	• • •	• • •	• • •
31	UNENCUMBERED FEE ..... Fee owner: The Port of New York Authority as assignee of Fortee Properties, Inc. Mortgagee: The Port of New York Authority as assignee of Central Savings Bank in the City of New York; proved claim for separate award in the amount of $14,748.08. Mortgagee: The Port of New York Authority, as assignee of Central Savings Bank in the City of New York; proved claim for separate award in the amount of $14,748.08.	$74,000 AA	$74,000 AA

The Port of New York Authority paid to the taxpayer, the petitioner herein, $45,030 in cash on December 17, 1947, and paid $28,970 to the Central Savings Bank in satisfaction of the mortgages. The taxpayer had no control over the payment or disposition of the $28,970 (R. 11).

The cost to the taxpayer of the disposition of the property was $933.33 (R. 11). Depreciation on the buildings to August 14, 1947 aggregated $2,116.63 (R. 10).

The petitioner herein applied to the Commissioner of Internal Revenue about March 1948 for, and the Commissioner on June 21, 1948, granted permission to establish a replacement fund for the net amount of $44,096.67 ($45,030, less $933.33) received by the taxpayer as a result of the involuntary taking of its two properties. The petitioner filed a bond approved by the Commissioner in connection with the replacement fund (R. 11).

In 1949, the petitioner reinvested the entire Replacement Fund in two other properties. Its total investment in one was $12,418.76 and it took that property subject to a mortgage of $48,000. Its total investment in the other was $33,904 and it took that property subject to a mortgage of $118,650. It thus invested in the two properties $2,226.09 in excess of the replacement fund (R. 11).

The Commissioner, in determining the deficiency for the fiscal year ended May 31, 1948, added to the income reported $28,970, described as "Gain on involuntary conversion," and explained that the long term gain realized on the involuntary conversion of the two properties is taxable in the amount of $28,970 (R. 12).

The Tax Court, however, decided that the petitioner had complied with the requirements of Section 112(f), and that no gain was to be recognized for income tax purposes since the $28,970 was paid to the mortgagee directly pursuant to separate award and the petitioner had reinvested all of the monies received by it as required by the section (R. 17).

The United States Court of Appeals for the Second Circuit reversed the Tax Court basing its decision on the rationale of *Crane* v. *Commissioner,* 331 U. S. 1, holding in effect that the $28,970 paid directly to the mortgagee pursuant to a separate decretal award and over which the petitioner "had no control over the payment of such

funds or the disposition in any way thereof" (R. 6) was "the money received" by the taxpayer, as mentioned in Regulations 111 Sec. 29.112(f)-1 (Appendix A, *infra*).

Specification of Errors to Be Urged.

The United States Court of Appeals for the Second Circuit erred:

1. In holding that the sum of $28,970 paid to the holder of the unassumed mortgages was required to be reinvested in "the acquisition of other property similar or related in service or use" (Section 112(f) of the Internal Revenue Code, Appendix A, *infra*), by the taxpayer who never received such sum "directly, indirectly or constructively" (R. 16) nor was such sum subject to its control having been paid to the mortgagee pursuant to a separate decretal award in the condemnation proceedings.

2. In holding that the rationale of the decision of this Court in *Crane* v. *Commissioner,* 331 U. S. 1, required the reversal of the decision of the Tax Court of the United States.

3. In failing to hold that the petitioner, having fully complied with Section 112(f) of the Internal Revenue Code, is entitled to a deferment of the recognition of its admitted gain at this time.

4. In reversing the judgment of the Tax Court of the United States.

Reasons for Granting the Writ.

Certiorari should be granted by this court because the Court of Appeals has distorted the rationale of *Crane* v. *Commissioner,* 331 U. S. 1, by extending it to the question of deferring recognition of a capital gain under Section

112(f). This court left open the question as to whether the gain of the petitioner under the circumstances of the case at bar should be presently recognized. The Court of Appeals having extended the *Crane* rationale to this case, the matter is now ripe for decision by this Court.

The Court of Appeals for the Second Circuit based its decision in this case squarely upon the decision of this Court in *Crane* v. *Commissioner,* 331 U. S. 1. The opinion of the Court of Appeals written by Judge Frank stated:

> While the *Crane* case can literally be distinguished as involving a different section and a different type of transaction, we think both the reasoning and spirit of the opinion are applicable here (R. 19).

and

> * * * In our view, the decision here should be governed by the rationale of *Crane* v. *Commissioner,* 331 U. S. 1, interpreting the meaning of "property" under §113 of the Internal Revenue Code (R. 19).

Yet the *Crane* case, as stated there by Judge Frank,

> * * * involved *the computation of tax gain* on the sale of depreciable property subject to a non-assumed mortgage (R. 19) (italics supplied),

while in the case at bar there is no dispute with regard to the computation of the gain. Both the Commissioner of Internal Revenue and the taxpayer agree that the gain which resulted upon the involuntary conversion was the sum of $34,786.29. The only question presented in this case is whether the petitioner, the taxpayer, fully complied with Section 112(f) of the Internal Revenue Code and "expended" the "money" into which its property had been "compulsorily or involuntarily converted" * * * "in the

acquisition of other property similar or related in service or use to the property so converted".[1]

The *Crane* rationale,[2] which does not apply to Section 112(f) but rather to Sections 111 and 113 of the Internal Revenue Code was erroneously extended by the Court of Appeals to the case at bar. The question of the *Crane* case is defined by this Court in 331 U. S. 1, at page 2 as follows:

> The question here is how a taxpayer who acquires depreciable property subject to an unassumed mortgage, holds it for a period, and finally sells it still so encumbered, must compute her taxable gain.

and at page 15:

> * * * The crux of this case, really, is whether the law permits her to exclude allowable deductions from consideration in computing gain.

This Court explicitly limited the application of the *Crane* rationale to the circumstances of that case and to Sections 111 and 113 of the Revenue Act of 1938 (now Sections 111 and 113 of the Internal Revenue Code). It carefully excluded any extended application, saying at page 10:

> Thus it appears that the applicable provisions of the Act[3] expressly preclude an equity basis, and the use of it is contrary to certain implicit principles of

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1. In his brief submitted in the Court of Appeals, the Commissioner stated "But the amount of gain (income) is conceded and the only dispute is whether it is recognized as taxable now or later". See also the opinion of the Tax Court (R. 15) "The amount of the gain and the basis for the replacement property are not in dispute in the present case, in which the only question whether all of the 'money' into which the condemned property was converted was invested in the replacement property. The *Crane* case did not involve section 112(f) and there is no sufficient reason for it to control the decision in the present case".

2. But note the dissenting opinion of Mr. Justice Jackson in which Mr. Justice Frankfurter and Mr. Justice Douglas join. 331 U. S. 1, 15.

3. Referring to Sections 111 and 113 of the Revenue Act of 1938.

> income tax depreciation, and entails very great administrative difficulties[30]

and in a footnote thereunder:

> [30]Obviously we are not considering a situation in which a taxpayer has acquired and sold an equity of redemption only, i.e., a right to redeem the property without a right to present possession. In that situation, the right to redeem would itself be the aggregate of the taxpayer's rights and would undoubtedly constitute "property" within the meaning of §113(a). No depreciation problems would arise.

and at page 12:

> * * * Whatever may be the rule as to allowing depreciation to a mortgagor on property in his possession which is subject to an unassumed mortgage and clearly worth less than the lien, we are not faced with that problem and see no reason to decide it now.

and in the concluding portion of the footnote 42 on page 15:

> * * * Whether or not the difference between the value of the property on acquisition and the amount of the mortgage would in that situation constitute either statutory or constitutional income is a question which is different from the one before us, and which we need not presently answer.

In the case at bar we are not concerned with Sections 111 and 113 nor with the question of basis since the question of the computation of the ultimate gain or loss has nothing to do with the question as to *when* gain or loss is to be recognized as provided in Section 112(f) nor do any principles of income tax depreciation nor administrative

difficulties intervene.[4] The Crane decision was intended to preclude absurdity.[5] In the case at bar the decision of the Court of Appeals unwarrantedly and unfairly denies the benefits of Section 112(f) to the taxpayer by making compliance with it either an absurdity or an impossibility.

The taxpayer, the petitioner herein, never received any part of the sum of $28,970 paid to the Central Savings Bank as the holder of the mortgages, nor did the payment of such funds in satisfaction of the mortgage liens relieve the taxpayer from the payment of any personal obligation. The taxpayer, not being obligated for the payment of the moneys paid by the condemning authority directly to the mortgagee pursuant to a final decree of the Supreme Court of the State of New York entered in the condemnation proceedings, nor receiving such moneys, nor having any possible control over the payment or disposition of such moneys, cannot be said to have received such moneys as contended by the Commissioner and, in effect, found by the Court of Appeals.

In the decision of the Tax Court below herein, it is stated (R. 16):

> The only amount which the Port of New York Authority paid to the petitioner or paid out for its benefit was $45,030 paid to the petitioner. It invested all of that money, plus some additional money, in acquiring property similar in use and service to that taken in the condemnation. The rather clear intention of Congress would be defeated rather than carried out if a part of the petitioner's gain were to be recognized because it did not also expend in the acquisition of similar property the $28,970 *which it did not have invested in the condemned property, for the payment of which it was not personally li-*

4. *Crane* v. *Commissioner*, 331 U. S. 1, 10.

5. Ibid, p. 13.

able, and which it did not receive directly, indirectly, or constructively. (Italics supplied.)

It has been repeatedly held by the Board of Tax Appeals and the Tax Court that Section 112(f) should be interpreted liberally as a relief provision. See *Massillon-Cleveland-Akron Sign Co.*, 15 T. C. 79, 83, where it held:

> • • • Section 112(f) is a relief provision, which takes cognizance of the inequity of taxing a gain resulting from the involuntarly conversion of property where the proceeds are used to replace the property, and should be liberally construed to effectuate its purpose. *Washington Railway & Electric Co.*, 40 B. T. A. 1249; *Davis Regulator Co.*, 36 B. T. A. 437; *Washington Market Co.*, 25 B. T. A. 576.

If the decision of the Court of Appeals were to be permitted to stand as a correct extension of the *Crane* rationale, then the relief intended by Congress would be unfairly and arbitrarily denied to the petitioner here and to others similarly situated. The deferred recognition of the capital gain realized would be denied under such a narrow construction since the monies, which the Commissioner has always insisted must be traced precisely, could never have reached the control or disposition of the taxpayer, either directly, indirectly or constructively, having been paid directly to the holder of the mortgages, as a separate award pursuant to the specific direction of the court (R. 11, 12, 13). It was impossible for the taxpayer to obtain the payment directly from the condemning authority and to pay the mortgage lien out of other funds directly to the bank. The mortgagee applied for a separate and direct award and such a separate and direct award was made by order of the New York Supreme Court (R. 11, 12, 13). There is and was no device by which the taxpayer could have de-

feated the right of the mortgagee to such direct and separate award.

> *Fliegel* v. *Manhattan Savings Bank,* 296 N. Y. 214; *Merriman* v. *City of New York,* 227 N. Y. 279.

In the opinion of the Court of Appeals herein it is asserted (R. 19):

> • • • The basis of the taxpayer's argument here is that, since he was not personally liable on the mortgage, he received no benefit and, hence, no gain on the satisfaction of the mortgage by payment to the mortgagee.

It is true that the petitioner made this argument upon the appeal to the Court of Appeals and still maintains that there is substantial merit to this contention. However the substantial argument made in the Court of Appeals was that the petitioner was entitled to the benefits of Section 112(f) having fully complied with its requirements, as was held by the Tax Court (R. 12).

In disposing of petitioner's contention that it received no benefit and no gain on the satisfaction of the unassumed mortgage, the Court of Appeals stated (R. 20):

> • • • Similarly, satisfaction of a non-assumed mortgage, by payment to the mortgagee, benefits taxpayer in the case at bar. In practical terms, for the purpose of protecting his property from foreclosure, where the value of the property is greater than the amount of the mortgage, the taxpayer-mortgagor has to treat the obligations of a non-assumed mortgage as if they were his personal obligations. Payment to the mortgagee relieved the owner of this necessity.

It is respectfully submitted that the line of decisions of this Court to the effect that the payment of a debt of the obligor by a third party to the holder of the obligation constitutes income to the obligor is controlling.

United States v. *Hendler,* 303 U. S. 564;
Old Colony Trust Co. v. *Commissioner,* 279 U. S. 716, 729;
Douglas v. *Willcuts,* 296 U. S. 1, 8, 9;
United States v. *Boston & Maine Railroad,* 279 U. S. 732.

Surely the same conclusion cannot be derived from the payment of what is not a debt.

Notwithstanding either interpretation of the method of computing the property rights of the taxpayer, it must be specifically understood that the petitioner herein has not excluded the amount of the mortgages in computing its capital gain. Accordingly the computation of its capital gain has followed the rule on basis as laid down in the *Crane* case. The distortion of the *Crane* rationale to make it apply to Section 112(f) invades and destroys the Congressional intent in the enactment and effect of this section.

See the opinion of the Tax Court (R. 12):

> The question is whether the petitioner has failed to comply with section 112(f) by not investing in his new properties the $28,970 paid under a separate award to the mortgagee of the mortgages on his condemned properties for which debt he was not personally liable. The sensible and just answer to that question seems clear—he has complied in every way that Congress intended. His property was condemned and involuntarily converted into money in the amount of $44,096.67, an approved replacement

fund was established with that money, and all of that money, and more, was invested in property similar to that taken in the condemnation.

CONCLUSION.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

IRWIN D. SHAPIRO,
Counsel for Petitioner.

June 25, 1954.

Appendix A.

Internal Revenue Code:

SEC. 112 [As amended by Sec. 151 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. RECOGNITION OF GAIN OR LOSS.

* * * * *

(f) *Involuntary Conversions.*—If property as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain shall be recognized, but loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain.)

* * * * *

(26 U. S. C. 1946 ed., Sec. 112.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.112(f)-1. *Reinvestment of proceeds of involuntary conversion.*—Upon the involuntary conversion of property described in section 112(f), no gain is recognized if the provisions of that section are complied with. If any part of the money received as a result of such an involuntary conversion is not expended in the manner provided in section 112(f), the gain, if any, is recognized to the extent of the money which is not so expended. For example, a vessel purchased by A in 1939 for $100,000 is destroyed by an enemy submarine in 1942, and A receives in 1942 insurance in the amount of $100,000. This money is not expended in the manner provided in section 112(f), but there is no gain since the insurance does not exceed the basis (disregarding, for the purposes of this example, the adjustment for depreciation). In 1947, A receives an award of $200,000 from the Government on account of the destruction of the vessel. He expends this amount in the manner provided in section 112(f). The gain in 1947 upon the receipt of this award is recognized to the extent of $100,000, the amount of the money received in 1942 which was not expended in the manner provided in section 112(f). The loss sustained as a result of an involuntary conversion described in section 112(f) is recognized. The expenditure in the manner provided in section 112(f) of money received upon an involuntary conversion is not necessary for the transaction to be considered completed for the purpose of determining such loss.
>
> In order to avail himself of the benefits of section 112(f) it is not sufficient for the taxpayer to

show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112(f) cannot be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. • • •

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 168

FORTEE PROPERTIES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 9-17) are reported at 19 T. C. 99. The opinion of the Court of Appeals (R. 18-20) is reported at 211 F. 2d 915.

JURISDICTION

The judgment of the Court of Appeals was entered on April 5, 1954. (R. 20-21.) The taxpayer's petition for a writ of certiorari was filed on June 25, 1954. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Whether, under Section 112(f) of the Internal Revenue Code, designed to postpone under certain circumstances the recognition of gain realized through an involuntary conversion, where property condemned is subject to a mortgage not assumed by the taxpayer, he must pay a tax on the portion of the condemnation price which was used to discharge the mortgage and which was not expended in acquisition of a substitute property.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute (26 U. S. C. 112, 113) and other authorities are set forth in the Appendix, *infra,* pp. 10-14.

STATEMENT

The facts as stipulated (R. 3-8) and as found by the Tax Court (R. 9-17) may be summarized as follows:

The taxpayer, a New York corporation, purchased two adjoining pieces of real property in New York on June 5, 1942. The properties were subject to two past due mortgages, one on each in the amount of $18,000, held by the Central Savings Bank as mortgagee. The taxpayer paid $4,000 in cash for the properties and incurred expenses of $397.01 in acquiring them. It took the properties subject to the mortgages but never assumed payment of, or legal liability for, the principal debt or interest covered by the mortgages. (R. 9-10.)

On August 14, 1947, the Port of New York Authority exercised its power of eminent domain and condemned the properties. The amount then due

on the two mortgages was $28,970. The taxpayer and the Port of New York Authority agreed that the total value of the properties on August 14, 1947, was $74,000 and the final decree of the court in the condemnation proceedings accepted their valuation. (R. 9-10.)

Pursuant to the court's decree, the Port of New York Authority paid the taxpayer $45,030 in cash on December 17, 1947, and paid the Central Savings Bank $28,970 in satisfaction of the two mortgages. The taxpayer had no control over the payment or disposition of the $28,970. (R. 11.)

The taxpayer incurred expenses of $933.33 in disposing of the properties. (R. 11.) Depreciation on the buildings to August 14, 1947, aggregated $2,116.63. (R. 10.)

Upon application, the Commissioner, on June 21, 1948, granted the taxpayer permission to establish a replacement fund for the net amount of $44,096.67 ($45,030 less $933.33) received by it as a result of the involuntary taking of its properties. The taxpayer filed a bond approved by the Commissioner in connection with the replacement fund. (R. 11.)

In 1949, the taxpayer reinvested the entire replacement fund plus $2,226.09 extra in two other properties. (R. 11.)

In determining a deficiency against the taxpayer for the fiscal year ended May 31, 1948, the Commissioner added to its reported income $28,970, described as "Gain on involuntary conversion," and explained that the long-term gain realized on the involuntary conversion of the two properties

was taxable in the amount of $28,970. (R. 12.) The Tax Court, however, found that the taxpayer had complied with the requirements of Section 112(f) and held that no gain was to be recognized for income tax purposes. (R. 17.) Reversing the Tax Court, the Court of Appeals found that under 112 (f) the "property" condemned included the mortgaged interest and that the money for that interest had not been expended on similar property so that the taxpayer was taxable on a long-term capital gain of $28,970. (R. 18-20.)

ARGUMENT

The decision of the court below is correct and this case does not warrant further review. Here, the taxpayer's properties were converted as a result of condemnation proceedings into money in excess of their adjusted cost basis. This necessarily resulted in the recognition of gain to it under Section 112(a), Internal Revenue Code (Appendix, *infra,* p. 10), unless the transaction fell within the non-recognition postponement provisions of Section 112(f) (Appendix, *infra,* p. 10). Section 112(f) states that no gain shall be recognized "If property * * * is compulsorily or involuntarily converted into * * * money which is forthwith in good faith, under regulations prescribed by the Commissioner * * * expended * * * in the establishment of a replacement fund."[1] Treasury Regulations 111,

[1] The amount of the condemnation award with respect to taxpayer's properties was $74,000. Admittedly, however, only $44,096.67 ($45,030 less expenses of $933.33) of such amount

Section 29.112(f)-1 (Appendix, *infra,* pp. 12-14), provide, as have the various Regulations promulgated under the internal revenue laws since 1934, that, if the Government retains out of a condemnation proceedings award sufficient funds to satisfy liens and mortgages and pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. Section 29.112(f)-1 also provides that the taxpayer must be able to trace the proceeds of the award into payments for property similar or related in use. The tracing provisions of Section 29.112(f)-1 have been consistently approved. *Lynchburg Nat. Bank & T. Co.* v. *Commissioner,* 208 F. 2d 757 (C.A. 4th); *Ovider Realty Co.* v. *Commissioner,* 193 F. 2d 266 (C. A. 4th); *Kennebec Box & Lumber Co.* v. *Commissioner,* 168 F. 2d 646 (C. A. 1st); *Twinboro Corp.* v. *Commissioner,* 149 F. 2d 574 (C. A. 2d), certiorari denied, 326 U. S. 754; *Commissioner* v. *Flushingside Realty Co.,* 149 F. 2d 572 (C. A. 2d), certiorari denied, 326 U. S. 754; *Winter Realty & Const. Co.* v. *Commissioner,* 149 F. 2d 567 (C.A. 2d), certiorari denied, 326 U. S. 754; *Vim Securities Corp.* v. *Commissioner,* 130 F. 2d 106, 109 (C. A. 2d), certiorari denied, 317 U. S. 686.

The crucial question in this case is whether the word "property" as used in Section 112(f) means the taxpayer's legal rights in the physical prop-

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was thereafter "forthwith * * * expended * * * in the establishment of a replacement fund". The balance of the award, i.e. $28,970, was used to discharge the mortgage indebtedness against the properties. (R. 11.)

erty undiminished by mortgages, assumed or unassumed, or merely his "equity" in the property. If the term "property" as used in the statute means the physical property undiminished by encumbrances, it necessarily follows as a result of the condemnation proceedings that the taxpayer realized a gain presently subject to taxation of $28,970, the amount paid to discharge the mortgage indebtedness against the properties. The Court of Appeals held, under the rationale of this Court's decision in *Crane* v. *Commissioner,* 331 U. S. 1, that the term was to be given such a construction. The Court of Appeals found, therefore, that the taxpayer's properties were involuntarily converted into money in the amount of $74,000 and accordingly held that the taxpayer realized a gain of $28,970 not invested in similar property and therefore immediately subject to taxation. The taxpayer contends (Pet. 5) that the Court of Appeals erroneously considered the rationale of this Court's decision in the *Crane* case to be applicable and that "property" as used in Section 112(f) means the taxpayer's equity interest in the property rather than his legal rights in the property undiminished by mortgages. Thus, the taxpayer claims that it fully complied with the requirements of Section 112(f) when it expended $44,096.67 ($45,030 less $933.33) of the total condemnation award in the establishment of a replacement fund. There clearly is no merit to the taxpayer's contentions.

In the *Crane* case this Court explicitly rejected such a construction of the analogous use of the word "property" in Sections 113(a)(5), and (b)(1)(B), and 111(b), holding that it meant the physical property undiminished by mortgages, whether assumed or not. The Court gave at least six reasons in support of this construction, all of which are equally applicable here.[2] Furthermore, if the term "property" as used in Section 112(f) were construed as being interchangeable with "equity", as the taxpayer contends, the statute would be converted from a postponement measure, which Congress intended it to be, into an escape device. Assuming such a construction were given the term "property", the taxpayer would only be required to pay tax on $5,816.29 of the $34,786.29 gain which it admits (Pet. 6) resulted from the condemnation of its properties. The difference of $28,790, the amount paid to discharge the mortgage indebtedness on the properties, would forever escape taxation.[3] In the circumstances it is plain

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[2] Sections 111, 112, 113 are, of course, in *pari materia* and throughout the many subsections of Sections 112 and 113 "property" includes the amount of the mortgage debt, whether assumed or not. See, e.g., Section 113(a)(18) and Rev. Rul. 95, 1953-1 Cum. Bull. 162-163.

[3] The taxpayer can trace $44,096.63 of its award into its two new properties. However, in computing their basis under Section 113(a)(9), Internal Revenue Code (Appendix, *infra*, p. 11), the taxpayer will be given credit only for $38,280.38 (original cost of $40,000 plus expenses of $397.01 less depreciation of $2,116.63 (R. 4, 10)), the adjusted basis of the condemned properties. Upon the subsequent disposition of the new properties, tax will be imposed on the $5,816.29 gain (total gain of $34,786.29-$28,790) on which the tax had been

that the Court of Appeals correctly construed the term "property" as used in Section 112(f) to mean the physical property undiminished by mortgages, assumed or unassumed, and that it correctly held, therefore, that the taxpayer realized a gain presently subject to taxation of $28,790 as a result of the condemnation of its properties.

There is also no merit to the taxpayer's claim (Pet. 10) that the Court of Appeals' construction of Section 112(f) "unfairly and arbitrarily" denies it and other taxpayers similarly situated "relief intended by Congress." On the contrary, it is clear that Congress intended just such a construction of Section 112(f). The House and Senate reports on the passage of the Act of October 31, 1951, c. 661, 65 Stat. 733, Sec. 1, whereby Section 112(f) was amended and its provisions to some extent relaxed as to conversions *after* December 31, 1950, make it plain that Congress approved of the construction which had been given to the statute and which the Court of Appeals gave it here. See H. Rep. No. 798, 82d Cong., 1st Sess., pp. 1-2; S. Rep. No. 1052, 82d Cong., 1st Sess., pp. 1-2.

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postponed because of taxpayer's compliance with Section 112 (f) to the extent of $44,096.63, assuming, of course, a favorable disposition of the new properties. Thus the tax on the $28,790 item would be avoided on the taxpayer's theory.

CONCLUSION

The decision below is correct. There is no conflict in decisions and no other reasons appear which would warrant further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JULY, 1954.

APPENDIX

Internal Revenue Code:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(f) [as amended by Sec. 151 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Involuntary Conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain shall be recognized, but loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended (regardless of whether such

money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain).

* * * * *

(26 U. S. C. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(9) *Involuntary conversion.*—If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in section 112(f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

* * * * *

(26 U. S. C. 113.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.112(f)-1. *Reinvestment of Proceeds of Involuntary Conversion.*—Upon the involuntary conversion of property described in section 112(f), no gain is recognized if the provisions of that section are complied with. If any part of the money received as a result of such an involuntary conversion is not expended in the manner provided in section 112 (f), the gain, if any, is recognized to the extent of the money which is not so expended. For example, a vessel purchased by A in 1939 for $100,000 is destroyed by an enemy submarine in 1942, and A receives in 1942 insurance in the amount of $100,000. This money is not expended in the manner provided in section 112(f), but there is no gain since the insurance does not exceed the basis (disregarding, for the purposes of this example, the adjustment for depreciation). In 1947, A receives an award of $200,000 from the Government on account of the destruction of the vessel. He expends this amount in the manner provided in section 112(f). The gain in 1947 upon the receipt of this award is recognized to the extent of $100,000, the amount of the money received in 1942 which was not expended in the manner provided in section 112(f). The loss sustained as a result of an involuntary conversion described in section 112(f) is recognized.

The expenditure in the manner provided in section 112(f) of money received upon an involuntary conversion is not necessary for the transaction to be considered completed for the purpose of determining such loss.

In order to avail himself of the benefits of section 112 (f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112(f) cannot be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property and itself pays the same, the amount so retained shall not be deducted from

the gross award in determining the amount of the net award. * * *

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